



**STATE OF MISSISSIPPI**  
**OFFICE OF THE STATE AUDITOR**  
**PHIL BRYANT**  
AUDITOR

March 18, 2006

**Financial Audit Management Report**

Honorable Tate Reeves, State Treasurer  
State Treasury Department  
P. O. Box 138  
Jackson, Mississippi 39205

Dear Mr. Reeves:

Enclosed for your review are the financial audit findings for the State Treasury Department for the fiscal year 2005. In these findings, we recommend the State Treasury Department:


1. Strengthen controls over the statewide collateral pool;
2. Strengthen controls over arbitrage calculations; and
3. Prepare monthly reconciliation of bank accounts.

Please review the recommendations and submit a plan to implement them by April 5, 2006. The enclosed findings contain more information about our recommendations.

During future engagements, we may review the findings in this management report to ensure procedures have been initiated to address these findings.

This report is intended solely for the information and use of management and Members of the Legislature and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

I hope you find our recommendations enable the State Treasury Department to carry out its mission more efficiently. I appreciate the cooperation and courtesy extended by the officials and employees of the State Treasury Department throughout the audit. If you have any questions or need more information, please contact me.

Sincerely,  
  
Phil Bryant  
State Auditor

Enclosures

The Office of the State Auditor has completed its audit of selected accounts included on the financial statements of the State Treasury Department for the year ended June 30, 2005. These financial statements are consolidated into the State of Mississippi's Comprehensive Annual Financial Report. The Office of the State Auditor's staff members participating in this engagement included Vicki Alvey, Kayla Jackson, Lucreta Walker, Katie Gilmore, Keian Grayer and Rebecca Wilson.

The fieldwork for audit procedures and tests was completed on December 20, 2005. These procedures and tests cannot and do not provide absolute assurance that all state legal requirements have been met. In accordance with Section 7-7-211, Miss. Code Ann. (1972), the Office of the State Auditor, when deemed necessary, may conduct additional procedures and tests of transactions for this or other fiscal years to ensure compliance with legal requirements.

### **Internal Control over Financial Reporting**

In planning and performing our audit of selected accounts included on the financial statements, we considered the State Treasury Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on these accounts and not to provide an opinion on the internal control over financial reporting.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted certain immaterial weaknesses involving the internal control over financial reporting that require the attention of management. These matters are noted under the heading **IMMATERIAL WEAKNESSES IN INTERNAL CONTROL**.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether selected accounts included on the financial statements of the State Treasury Department are free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. We are pleased to report the results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

## IMMATERIAL WEAKNESSES IN INTERNAL CONTROLS

### Controls over the Statewide Collateral Pool Should Be Strengthened

#### *Finding:*

The State Treasury Department maintains the Statewide Collateral Pool and is responsible for ensuring that state funds held in depositories/banks within the pool are adequately collateralized in accordance with state laws. To facilitate this process, the agency obtains deposit reports monthly from each of the depositories/banks within the pool. The agency has developed a daily collateral spreadsheet to compare the deposit reports obtained from the depositories/banks with its collateral records to ensure that the proper amount of collateral has been pledged to the State Treasurer by each depository/bank. Each day the spreadsheet is updated for changes in the market value of collateral, while the deposit information is updated monthly. The spreadsheet is monitored daily for deficient depositories/banks or other significant changes (i.e., significant market changes). All deficient depositories/banks are contacted to submit additional pledged securities.

Our review of the daily collateral spreadsheets prepared by the agency revealed the following:

- During our review of depositories/banks deficient in pledged collateral, we noted two instances out of ten in which the information submitted by the depository/bank per the monthly deposit report was not entered correctly on the daily collateral spreadsheet. In one instance, this resulted in one depository appearing to be deficient in collateral when the depository actually had sufficient collateral.
- During our review of depositories/banks deficient in pledged collateral at June 30, 2005, we noted one instance in which a deficient depository/bank did not properly collateralize deposits in a timely manner. During the month of July 2005, the depository appeared to have been properly collateralized per a review of the daily collateral spreadsheet. However, we noted the required amount of collateral to be pledged had been incorrectly calculated on the daily collateral spreadsheet by agency personnel and the depository/bank was still deficient. Because of the error in calculating the amount of required collateral, agency personnel did not contact the depository/bank. The depository/bank was properly collateralized in August 2005.
- During the statewide collateral pool testwork, we noted four instances in which the Federal Deposit Insurance Corporation (FDIC) calculations on the daily collateral spreadsheet were incorrectly computed by agency personnel. These errors ranged from an overstatement of \$118,943 for one bank and understatements ranging between \$116,896 and \$4,030,137 for the remaining three banks. However, we noted the depositories/banks were sufficiently collateralized despite the errors.
- The monthly deposit reports for the Treasury demand accounts utilized to prepare the daily collateral spreadsheet are not compared to the monthly bank account statements received from the depositories/banks to ensure propriety.

Good internal controls dictate that reports receive an adequate review by supervisory personnel to ensure accuracy and completeness. Failure to properly review reports could allow errors to occur hindering the State Treasury Department in ensuring that all state funds in the Statewide Collateral Pool were properly collateralized as required by state law.

*Recommendation:*

We recommend the State Treasury Department strengthen controls over the preparation of the daily collateral spreadsheet by exercising greater care to ensure the spreadsheet is properly reviewed for accuracy by supervisory personnel. We also recommend that agency personnel compare the monthly bank statements received from the depositories/banks for Treasury demand accounts to the monthly deposit reports used to compute the collateral spreadsheet to ensure propriety.

Controls over Arbitrage Calculations Should Be Strengthened

*Finding:*

The Tax Reform Act of 1986 requires a calculation, on every fifth anniversary of a bond issue, of the arbitrage rebate with excess earnings, if any, to be remitted to the Internal Revenue Service (IRS) by the sixtieth day after the anniversary of the bond issue's closing date. To aid in compliance with IRS regulations, the State Treasury Department has entered into contracts with attorneys specializing in arbitrage calculations. Agency procedures include providing arbitrage schedules, prepared by agency personnel, to the arbitrage attorneys. The schedules indicate the bond issues with required calculations due during a fiscal year.

During testwork performed at the State Treasury Department for fiscal year 2005, we noted the following:

- Of 11 bond issues tested, seven instances were noted in which the arbitrage attorneys had not submitted documentation of arbitrage calculations by the due date. Agency personnel noted that if no payment was due to the IRS, as was the case with these seven bond issues, the attorneys would verbally inform the agency and then send a letter with the arbitrage calculations. However, we noted that letters for three of the seven bond issues were received from one to two months late. We also noted that letters for four of the seven bond issues were not on file at the time of our testwork and had to be requested. At the time of receipt, these four letters were four to eleven months after the due date.
- Our review of the arbitrage schedules prepared by agency personnel for bond issues with an arbitrage calculation due in fiscal year 2005, revealed there was no supervisory review of the schedules to ensure they were properly prepared and mailed to the attorney for preparation of the rebate calculation.

Good internal controls would dictate that a supervisory review be made of the arbitrage schedules to ensure completeness and accuracy. Controls should also be in place to ensure the date of the submission of the schedules is recorded and the resulting required arbitrage calculations tracked to ensure receipt by the due date. Failure to ensure arbitrage calculations are performed in a timely manner could result in interest being due for untimely payments and cause the agency to be out of compliance with IRS regulations which could impact the state's ability to issue tax exempt bonds. Also, failure to have arbitrage calculations on file hinders the audit process and would also hinder an efficient audit by the IRS should the agency be selected for review.

*Recommendation:*

We recommend the State Treasury Department strengthen procedures over the arbitrage calculations by implementing a supervisory review of the arbitrage schedules prepared by agency personnel to ensure completeness and accuracy. We further recommend the agency implement a tracking system to ensure timely receipt of arbitrage calculations and ensure that all required documentation is on file at the agency.

Bank Reconciliations for Bank Accounts Should Be Prepared

*Finding:*

The State Treasury Department receives and maintains several bank account statements for the Mississippi State Tax Commission. During our review of the State Treasury's monthly bank reconciliations for all bank statements, we noted the agency had not prepared monthly reconciliations for AmSouth Tax Commission bank accounts. Good internal control procedures require the reconciliation of monthly bank statements with financial records. Failure to reconcile bank statements with financial records could result in errors or fraud occurring without being detected in a timely manner..

*Recommendation:*

We recommend the State Treasury Department ensure monthly bank reconciliations are prepared for all bank accounts. Differences on these reconciliations should be investigated and resolved.